



EcC
M6893

Modern business lectures.

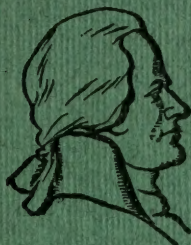
No.1,3-10, 12,13, 15-17, 19-24

Ecc
M6893

Modern business lectures

THE FOREIGN EXCHANGE FIELD

By LAWRENCE MERTON JACOBS



MODERN BUSINESS
LECTURE No. 17
(WITH VOLUME 17)

ALEXANDER HAMILTON INSTITUTE
NEW YORK

R.A. 33

FH 198



The Foreign Exchange Field

By

LAWRENCE MERTON JACOBS

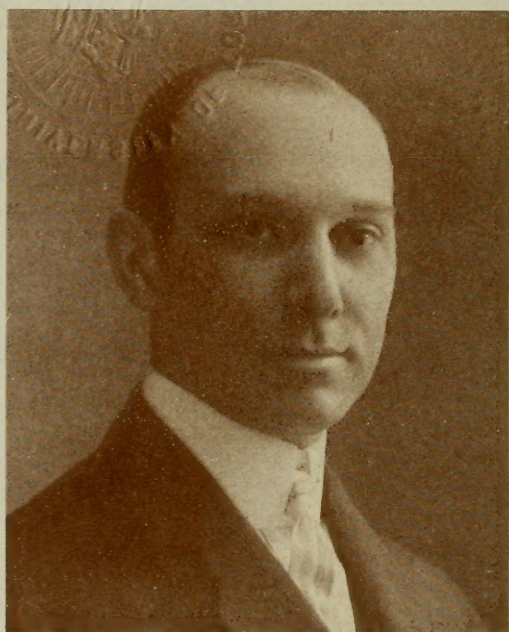
Vice-President International Banking Corporation, New York City

This Lecture, to be read in connection
with Volume 17, forms part of
READING ASSIGNMENT 33

**ALEXANDER HAMILTON INSTITUTE
NEW YORK**

Copyright, 1918 by Alexander Hamilton Institute
Copyrighted in Great Britain in 1918
All Rights Reserved

0
232893.
6 29
1



LAWRENCE MERTON JACOBS

LAWRENCE MERTON JACOBS

Born in Sturgis, Mich., 1878, Mr. Jacobs was graduated in 1899 from the University of Chicago where he had specialized in Economics and Political Science. Subsequently he obtained a position in the Treasury at Washington where he continued his study of finance. In 1900, Mr. Jacobs went to the Philippines on Government business, and thereafter visited Japan, China and countries in Europe. In 1903 he entered the Bond department of the National City Bank of New York and three years later the Foreign department. In 1909 Mr. Jacobs was sent to London as European representative of the National City Bank. His travels in Europe brought him in close contact with British and Continental bankers and gave him an intimate knowledge of their banking methods. When in 1915 the National City Bank interests acquired the International Banking Corporation and the International Bank, he was made vice-president of the former and president of the latter.

Mr. Jacobs is a member of the American Academy of Political and Social Science, the American Asiatic Association, the Society of Colonial Wars, the Sons of the Revolution, the Saint Nicholas Society, the New York Genealogical and Biographical Society, the Pilgrims (of Great Britain), and is a Fellow of the Institute of Bankers, London.

LAWRENCE MERTON JACOBS

NOTE:—This Lecture, which is based upon the author's ripe experience in his special field, should be read in the light of the Modern Business Text, and should be studied as an authoritative message from the field of present-day business activity.

The Foreign Exchange Field

By

LAWRENCE MERTON JACOBS

Foreign exchange is—at least it should be—a subject of immediate interest to very many Americans. The young man who is seriously endeavoring to prepare himself for a business career; the manufacturer who imports his raw material or whose finished products are suited to foreign markets; the banker who is alive to the many great economic opportunities which the war has opened to us, and the statesman who with true and far-seeing patriotism is seeking to equip the country with the best possible financial machinery—all these are necessarily interested in the subject of foreign exchange.

Perhaps no phase of banking is so shrouded in general misconception as foreign exchange. I was first attracted to it by being given to understand that it was a very intricate and interesting subject and that the late J. P. Morgan was almost the only Simon-pure American who really understood it. I observed that foreigners, largely Germans, filled the exchange departments of our banks, and I concluded that under such conditions we should never make much headway in the business of foreign banking. I also be-

lieved that our national banking system should give way to a system which would take account of foreign, and not only of domestic trade. I felt that if our banking laws were brought up to date, an immense stimulus would be given to our foreign trade, and that it was essential that Americans should gain a comprehensive knowledge of foreign exchange, both theory and practise. I felt that the solution of many of our foreign banking and trade problems must come from men of intense Americanism, proud of their country's history, thinking less of the exchange profits of the moment than of helping America's trade interests—men who would be able, because of similarity of birth, breeding and education, to see eye to eye with the domestic bankers who control our great financial institutions.

Simplicity of Foreign Exchange

I discovered that contrary to the generally accepted idea, there is nothing difficult or mysterious about the subject of foreign exchange. Compared with botany, trigonometry, Roman law and many other subjects which students encounter in their college course, it is really simplicity itself. An understanding of foreign exchange requires no more mathematics than that which one acquires in the course of an ordinary grammar-school education. Given quotations of one or two exchanges, one can readily determine the exact parity for another. If you are in Shanghai and know at what rate you can sell a telegraphic transfer

on New York and what rate New York is paying for francs, you do not have to be a genius to ascertain what price you can afford to pay for a cable transfer on Paris. You simply have to ascertain how many francs equal one Shanghai tael, if one Shanghai tael equals \$1.05 in United States currency, and if \$1.00 U. S. currency equals 5.70 francs. The whole problem is one of simple proportion as follows:

$$5.70:1 = X:1.05$$

from which we find that one tael equals 5.985 francs.

So much for the great mystery of arbitrage. Discount and interest have to be figured when, for example, you are selling telegraphic transfers against borrowed funds and employing the proceeds in bills that will not mature for some time.

Foreign exchange involves little more than dealing in short-dated securities, in bank paper and commercial paper collaterally secured by goods in process of shipment either from or to a foreign country. The normal risks attendant upon such transactions are infinitesimal, and our schools of banking and finance, such as the Alexander Hamilton Institute, will have accomplished a national good if they succeed in ridding the minds of our business men of the foreign exchange bugaboo; for the result will be not only an enlargement of our business horizon, but actual economies in the use of cash and credit.

Buying raw materials or selling finished products in foreign countries does not necessarily mean dangerous exchange risks for our manufacturers. Al-

most any situation of that nature can be met by foreign exchange bankers, if they are given an opportunity to consider and investigate the circumstances. This is one of the attractions of the exchange business. It affords unusual scope for the exercise of ingenuity, and inasmuch as Americans are generally supposed to be an ingenious people, it is remarkable that we should not have excelled in it. That eventually we shall excel in it I have no doubt whatever.

Establishing Ourselves Abroad

Generally speaking, in this country we think of foreign trade chiefly in relation to our exports of manufactured articles. Now and then we have great waves of enthusiasm with respect to the possibility of developing foreign markets for our goods. We should remember, however, that much of our present foreign trade has been built up while Europe was at war, and we must be prepared for a material contraction in our exports when war supplies will no longer be demanded by our allies and when European salesmen are once more in the field. Furthermore, we should consider that both British and German export trade has been built up in large measure by British and German merchant firms scattered here and there over the world, and that until American concerns are equally well established and have men on the spot to urge the purchase of our goods, we shall be at a decided disadvantage.

If we are to make marked headway in the development of our exports, it is highly desirable that a large

number of our young men should make definite plans to go abroad upon the completion of their school work. Once they have experienced the charm of life abroad, especially in the eastern countries, they will be satisfied to remain for a considerable period. It is advisable, however, that those who are only sons should leave this field to others—to those who have elder brothers or who are not likely to be compelled to return home for family reasons.

Buying Raw Materials at First Hand

As manufacturers, we should give greater thought to economies in the purchase abroad of the raw materials from which our manufactured goods, both for home and foreign consumption, are largely made. Misapprehension as to exchange risks now deters many manufacturers from direct purchases and thereby multiplies middlemen's profits in the form of commissions which might have been saved. Altho no doubt many of our large manufacturing enterprises are acquainted with the existing sources of supply of their raw materials, probably many smaller plants would attempt to buy their supplies at first hand if they knew with what ease they may do so and with what little exchange risks even in the most unlikely parts of the world. If after the war we may expect a period of keen trade rivalry, it will be of importance to our manufacturers to buy their materials as cheaply as possible.

Our Dependence Upon the Outside World

To some it may come as a shock to learn that our school-boy concept of this country—namely that it is self-sufficient—is incorrect. True, we produce a great variety and large quantity of food materials, but we are dependent upon the outside world for a great deal of manufacturing material. Some figures taken from the foreign trade record published by the National City Bank show not only the vastness of our economic dependence, but also its rapid increase with the increased demand for our manufactures.

The 1917 activity of the manufacturers of the United States is evidenced by the fact that the value of manufacturing material imported in 1917 was double that of 1915. The value of manufacturing material imported in the calendar year 1917, was in round terms \$1,800,000,000 against \$957,000,000 in 1915 and \$874,000,000 in 1914. Manufacturing material formed 61% of the total merchandise imported in 1917 against 54% in 1915 and 49% in 1914.

Another evidence of the activity of the manufacturers of the United States in the year just ended, is found in the fact that the value of manufactures exported in the calendar year 1917 aggregated nearly \$4,000,000,000 against \$1,791,000,000 in 1915 and \$974,000,000 in 1914.

Thus manufacturing material imported in 1917 was nearly double that of 1915 and more than double that of 1914, and manufactures exported were more than double those of 1915 and four times as much as in 1914, the year in which the war began.

These large increases in manufacturing material imported occurred in nearly all of the important articles of foreign production required in our industries. India rubber imports of 1917, for example, aggregate over 400,000,000 pounds against 270,000,000 pounds in 1916 and 221,000,000 in 1915, and the value in 1917 was approximately \$240,000,000 against \$160,000,000 in 1916 and \$111,000,000 in 1915. Hides imported in 1917 show a slight increase in quantity, when compared with

1915, but a large advance in total value, aggregating for 1917 over \$200,000,000 in value against \$173,000,000 in 1916, \$127,000,000 in 1915 and \$112,000,000 in 1914. Raw silk imports of 1917 show a total value of nearly \$200,000,000 against \$150,000,000 in 1916, \$95,000,000 in 1915, and \$93,000,000 in 1914. Wool imports of 1917 aggregate in value over \$150,000,000 against \$125,000,000 in 1916, \$95,000,000 in 1915 and \$58,000,000 in 1914. Tin imports of 1917 show a total value of approximately \$70,000,000 against \$56,000,000 in 1916, \$39,000,000 in 1915 and \$33,000,000 in 1914. Fibers show an aggregate value in 1917 of about \$100,000,000 compared with \$66,000,000 in 1916 and \$45,000,000 in 1915. Raw cotton shows a total value for 1917 of approximately \$46,000,000 against \$26,000,000 in 1915 and \$23,000,000 in 1914.

The share which the manufacturers of the country have in the foreign trade shows a marked growth as a result of the war. Raw material imported for manufacturing formed in 1917, 43% of the total imports against 33% in 1914; manufactures for use in manufacturing, 18% compared with 15% in 1914, and total manufacturing material 61% of the total imports of 1917 against 48% in 1914. Manufactures exported formed 66% of the total exports in 1917 against 51% in 1915 and 47% in 1914.

In more ways than one, we are rapidly emerging from our position of isolation, and it is pertinent for our manufacturers to set themselves thinking about the various ways they hitherto have taken to pay for all these materials, and what their ignorance of simple exchange principles and practice has cost them in the shape of middlemen's profits and commissions.

The Proper Starting Point

For the business man who wishes to acquire a working knowledge of foreign exchange, the starting point should not be technical books with their confusing array of calculations, with their mint parities, kilograms, troy weights, freight, insurance, degrees

of fineness, bill stamps, brokerage, mint charges, premiums, discounts, and what not; but rather a few concise details regarding the currency system of the country in which he is especially interested, either as a buyer of its raw materials or as a consumer of its finished products. If, for example, he is interested in silk, it would be well to acquire some facts about the currency systems of Japan and China. He does not have to know the effect on the Chilean peso of extraordinary gold importations, the probabilities in connection with a further issue of paper money in Brazil, the effect on Persian krans of British military operations in Asiatic Turkey or what influence on Dutch guilders the lack of tonnage to move the Java crops to the world's markets may have. Nor is it necessary for him to consider how the price of jute in India may be affected by a raising of the rate for India Council bills in London. These are matters for the Exchange banker. The business man needs only to specialize in the currency and exchange peculiarities of that country which touches his own business and pocket book.

Four Currency Systems

The currency systems of the world fall within four principal divisions, namely:

1. Gold Standard countries.
2. Gold Exchange Standard countries.
3. Silver Standard countries.
4. Countries where a depreciated paper currency forms the bulk of the circulating medium.

England and Japan are examples of countries with a gold standard like our own. British India and the Straits Settlements are examples of countries possessing a gold exchange standard. China is a silver country and Brazil and Chile are countries with depreciated paper currencies. The outstanding fact about exchange between the United States and countries falling within these divisions is simply one as to extent of fluctuation in quotations—the swing of the pendulum between high and low points. Between the United States and England and Japan, for example, exchange normally fluctuates within narrow limits, determined by the point at which it is cheaper for the banker to ship gold than to buy bills of exchange. Between the United States and gold exchange standard countries, exchange fluctuations are also kept within narrow limits, but in this case by artificial means, the Government of India or the Straits Settlements entering the market as a buyer or as a seller at such times as seem necessary in order to maintain the exchange equilibrium. Between the United States and China, exchange fluctuations are dependent not only upon changes in trade currents or upon favorable or unfavorable balances of trade, but upon fluctuations in the price of silver itself. As might be expected, here we find wide and irregular swings of the exchange pendulum. Between the United States and Chile and Brazil, exchange oscillates even more violently, the national currencies of those countries being largely products of the printing press, and the quantity outstanding depending

upon the whims of legislators and ministers of finance.

Dollar Exchange

Since the outbreak of the war in 1914, much has been said about the establishment of the dollar in various foreign markets and about the increased use of dollar credits. Of late we have even heard the suspicion voiced that the loans we have been making to our allies are being utilized in considerable measure to the detriment of dollar exchange and the maintenance of the value of the pound sterling in the markets of the world. Not only have such statements the tendency to create discord between our allies and ourselves, but they are absolutely without foundation in fact. There is nothing hidden; no exchange trickery is going on at the expense of America. "Why", we are asked, "should the American dollar be at a discount in Spain, for example, at the very time when trade statistics show that we are exporting more goods to Spain than Spain is exporting to us?"

The explanation is simple. In the first place, France and England have been importing from Spain vastly more than they have been exporting to that country. For these imports they have paid in sterling or francs. But the Spaniard has not wanted money in London and Paris, so he has looked around for a market where he could trade to the best advantage his sterling and francs for pesetas. He found that market in New York, where with a balance of trade against Spain it was to be expected that pesetas would

be cheap; and this process has been continued until even in New York the peseta has increased in value beyond its normal level. We must also remember that we have owed Cuba large amounts of money for our sugar purchases, and that a good part of Cuban sugar profits has been earned by Spaniards living in Spain. The result has been the paying of a portion of our debt to Cuba by purchases of pesetas, naturally driving them to a premium, since we have been unwilling to ship gold.

Trade statistics are valuable as indicating the amount of commodities of various kinds which are being imported and exported, but we must not argue too much from them. They do not show all the factors in an exchange equation.

The Dollar Follows Trade

It is unquestionably a highly commendable national ambition to improve the market for dollars wherever possible. As practical men, however, we should be ready to recognize that water will not of its own accord run up hill. It is the same with dollar exchange. The breadth and permanence of the market for dollars will depend primarily on the breadth and permanence of our trade with a given market. We are today importing a vast amount of nitrate and copper from Chile, and in consequence of a comparative lack of competition from Europe we are exporting to Chile a considerable quantity of manufactured goods. The natural result has been the creation of a hitherto unknown amount of dollar exchange in

Valparaiso and an exceptionally broad market for it. When peace comes it is to be expected that there will be a decidedly lessened demand from America for such war materials as copper and nitrate, and we may again feel the force of European competition in those manufactures which enter most largely into Chilean consumption. The effect of such shrinkage of trade would be a sharp contraction in the market for dollar exchange in Valparaiso.

That particular exchange—sterling, dollars or francs—in which at a given point there is the greatest amount to be dealt in, tends naturally to possess the broadest market. This is determined by the destination of a given country's exports and the source of its imports. Those who are familiar with security markets know that there is a better market for United States Steel common than for other stocks that perhaps are just as good but of which there is not so large a quantity being dealt in day after day. Thousands of shares of Steel can be bought almost without altering quotations. Bids or offers of equal quantities of some other security might cause an advance or decline of several points. It is just so with sterling in Calcutta and with guilders in Batavia. The activity of a given exchange (dollars, sterling or francs) and the closeness of quotations between the buying and selling price, depend, moreover, on the number of banks trading in it, the nationalities of those banks, the source or location of their facilities for finance and the possibilities of their securing cover. If, for example, the preponderance of trade

with India is British, and if British banks are more numerous than American banks at, say, Bombay, there will be more demand for sterling than for dollars, primarily perhaps because the purchase of dollar exchange—say ninety days' sight bills—by British banks with their principal offices in London, involves such banks in a risk in the cross-rate between New York and London for the period that the bills are in transit from Bombay to New York.

When we are inclined to wax enthusiastic about the possibilities of the dollar ousting the pound sterling from its position as the principal exchange medium of the world, it is desirable to leave theory aside and get down to actual conditions. When a bill of exchange drawn in dollars is offered for sale, we should ask ourselves where the funds are to come from to pay for it. In many cases it will be found that bank deposits in that particular country are difficult to secure and that to get the money our bank will have to sell some other kind of exchange. The consequence of this situation is that banks will naturally give a better price for the kind of exchange they are going to sell than for some other exchange which will involve perhaps a delayed transfer of funds from a third market.

Generalizations about dollar exchange, therefore, are at best unsafe. In some places dollar credits may be more economical than sterling credits, and in others more expensive. Furthermore, what is true at one season of the year, may not be true at another. But as and where our trade develops, the market for

dollar exchange will broaden and a field will be created for more American branch banks.

Stability of Exchange Rates

When our money market provides cheaper discounts than London at equally stable rates, we shall also see a decided improvement in the market for dollars everywhere. Before this stage is reached, however, we still have some distance to go. The Federal Reserve Act has vastly increased our foreign trade possibilities, but we do not yet possess a smooth working national discount market. Whether this is even attainable is a question. With a multiplicity of banks we have a multiplicity of acceptances, and we find in New York a variety of rates for a variety of paper. London has one discount rate and one class of acceptances to which that rate applies. That rate is telegraphed daily all over the world and has the effect of standardizing, as it were, sterling exchange. It is the rate for the discount of ninety days' sight prime bankers' bills. Uniformity of security and uniformity of rate are an achievement which we have yet to reach. Our rate for call money is still the rate at which funds can be loaned from day to day on the stock exchange instead of being, as in London, the rate at which bill brokers can borrow from the banks to carry foreign-drawn acceptances which they have purchased. This London call rate is also telegraphed all over the world. The world is not interested in knowing how somebody can borrow against stock exchange securities in Wall Street, but it would ma-

terially improve the market for dollar exchange in distant centers if the rate were known at which money could be borrowed for short periods against bills of exchange, especially if there were evidences of stability in that rate, making unlikely any important changes in the discount rate.

Stability of rate and uniformity of rate go hand in hand and New York will not be a world's discount market until there are less wide fluctuations in call money and in discount rates. As yet we give our mercurial temperament too much play by our quick swings from fear to confidence and from confidence back to fear. Stability is of great importance in building up our foreign trade and in broadening the market for American exchange, especially in view of the fact that it is the custom in many countries for merchants to settle their exchange forward, that is weeks and often months before the bills are actually drawn. The purchasing banker, therefore, has to form a careful estimate of money and discount probabilities in London, if they are sterling bills, and in New York if they are dollar bills. That he will discriminate against dollar credits if there are signs of unsteadiness in New York money rates is evident. Not only are bills sold forward, but after they are once delivered to the buyer, it takes in some cases upward of two months for them to reach their destination, be accepted, and become discountable. They are a long time afloat.

The Federal Reserve System

That efforts are being made to improve the conditions of our New York discount market, to regularize and stabilize it, we know, and we must be patient. Our Federal Reserve System is a ponderous machine which requires careful adjustment. Many of its difficulties are doubtless due to the fact that a large number of state banks and trust companies are still outside. This realization of the present incompleteness of the system begets a fear that in times of credit expansion or inflation, it may not be equal to the strain put upon it; that the non-member banks may drain the system of its gold and weaken the whole machine. This fear militates against the ready and continued use of the discount facilities of the reserve banks which this system requires for its smooth working. More and more banks are joining the system, but there are still thousands outside, and it is a question whether they should not, by a stroke of the pen, be made to come in, just as state banks were forced into the national system during the Civil War when Congress put a tax of 10 per cent on state banks' notes. It is likely that if a tax of 10 per cent were placed on all checks drawn on non-member banks, such a measure would have the desired effect.

The Need for Large Advances by the Federal Reserve Banks

It has been suggested that a Government Exchange Bank be established to cooperate with the Federal

Reserve Banks. Although it is a matter of real satisfaction to know that the Senate Committee on Banking and Currency is devoting some attention to our exchange problems, I do not see the necessity for a separate bank, especially if the main idea behind its creation is to protect dollar exchange against supposed secret assaults upon it by those who are interested in the pound sterling. A bank so created would, I believe, rest upon an economic fallacy. What our present exchange situation requires more than anything else as a means of creating a demand for dollar exchange in the markets of the world, is not another bank but a placing at the disposal of our exchange bankers by the Federal Reserve Banks large credits which may be immediately availed of for the purchase of dollar exchange, drawn in connection with either imports or exports. Our exchange banks would then be on a parity with British foreign and colonial banks which receive ample sterling credits or advances from the great London joint-stock banks which are unhampered by statutory limitations. Our laws now limit the amount which a national bank may lend any borrower to 10 per cent of its capital and surplus. In view of the magnitude of our foreign trade and the immense sums necessary to finance it, the removal of this restriction with respect at least to advances against foreign bills of exchange, spot bills and bills to arrive—self-liquidating securities which the British with their long experience have come to reckon on a par with Government Treasury bills—would be a magnificent legislative achievement.

A Practical Difficulty

It is a matter of real satisfaction that we possess a Federal Reserve Board of unusual distinction and wisdom doing its utmost to improve our national discount market and to enlarge the facilities at the disposal of banks doing an exchange business. Both these efforts are sure to be most helpful in sweeping away legal restrictions upon our foreign trade. Even then, however, there will remain a difficult situation. The manner in which we meet this situation will determine in large measure the future growth of our export trade. The situation is this: nearly every country in the world wants capital—British India, Colombia, Australia, Brazil, Java, Argentina, China, eastern countries and western countries. As we provide that capital our trade with those countries will tend to expand. But how are we to provide it? Are our foreign branch banks to do it? Certainly not. Branch banks must keep their funds liquid, must keep turning their money over and over in financing trade, both import and export. What undeveloped countries need is fixed capital—five, ten, twenty-year lock-ups to build railroads, develop water power, improve sanitary conditions, establish municipal markets, and so forth. Lend them the money and they will be happy to buy their supplies from us—just as in the past they have bought them from England, France and Germany. Money so loaned **will** be economically expended—under our own supervision, if necessary—for much-needed public improvements.

As we think of the distant countries which we have never seen, towns and rivers of which we have never heard, it is natural that a feeling of apprehension should seize us. We are likely to say: "If foreign trade development means buying bonds of outlandish towns and shares in companies with unpronounceable names, situated goodness knows where, we pity those who with high hopes are painting with rosy colors our foreign trade future. We know that as individuals we are not going to put any of the hard-earned money we have left over from the income-tax gatherer into such bonds even if they do pay 12 per cent, and into such shares even if they promise to pay 20 per cent."

The Debenture Company

Nevertheless, the situation is not hopeless. There is in fact a very definite way out of the difficulty. We should by legislative enactment introduce into this country one of the most effective agencies evolved out of British financial experience. I refer to the debenture company. This company has a paid up capital of a given amount which it invests in comparatively small amounts in the securities, bonds and shares of a great number of different companies, located in different parts of the world. It then offers for sale its own debenture bonds, pledging as security not only all the bonds and shares it has bought with its capital, but also all those securities which it is going to buy with the money it gets from the sale of its debentures. These debentures are, therefore, secured

by twice their amount in assets plus any surplus reserve which a well-managed company will have accumulated and set aside. So well secured are they that the British Parliament has made them legal investments for trustees and similar investors.

Especially valuable are the debentures for investors who lack financial experience, who seek safety rather than large returns. There are many such companies in Great Britain, some with large capital and debenture issues and some with small; some that specialize in one general field of investment and some in another. The grand total of their funds available for investment amounts to millions and millions of pounds sterling.

We need similar companies in the United States. The main obstacle to the project in this country lies in the fact that the several states determine for themselves what specific securities trustees and savings banks may buy. It would be necessary, therefore, to educate a large number of state legislatures on the subject of foreign trade and foreign exchange and debenture companies in order to get legislation that will include among legal investments such debentures as I have described. This is a task of huge dimensions and unlikely of accomplishment within any reasonable period of time.

There is, however, as I have said, a way out of the difficulty. This is for the Government in Washington to authorize the formation of debenture companies, subject to the approval and supervision of the Federal Reserve Board or of some board especially

created for the purpose. Deposits of public funds can then be made with these companies against the security of their debentures. With government funds on which only a moderate rate of interest is to be paid, our American debenture companies would be on a par with British companies in respect to the price paid for their loans. For example, prior to the war, British debenture companies were able, by reason of the fact that debentures were approved investments for trustees, to sell them to the public on a 4 per cent to a $4\frac{1}{2}$ per cent interest basis.

We have as yet no market in this country for such debentures and, as we have seen, small chance of creating one because of the restrictions of state laws regarding trustees' investments. Accordingly, if we would seize the opportunities which lie within our reach, the Government must for the time being take the place of the private investor until our state legislatures have had time to study the subject and to amend their laws.

An Illustrative Case

We shall need debenture companies if we are to develop our foreign trade and if, as a nation, we are to do our duty toward other less favored countries. An illustration will make the situation clearer. Java, we will say, is very much in need of funds to build a railroad. The population is there, the agricultural situation is of the best, and there is no question about the railroad being a paying enterprise once it is completed and in operation. American engineers are sat-

isfied that the situation is a favorable one. American manufacturers would be glad to supply the materials. Young Americans would be eager for an opportunity to go abroad for a few years and get a foothold somewhere.

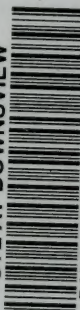
So far, all is well. We now find ourselves confronted with the fact that nowhere can we get the capital required. Private investors in this country know little or nothing about Java and are not prepared to invest their money in far-away enterprises that have not even reached the going stage. A bank or finance house might easily be found to underwrite the issue, but only if it were possible gradually to make a public distribution of the securities. Since banks and bankers cannot lock up their funds, they cannot take interest in our Java enterprise because they will not be able to dispose of the bonds and shares to the public—and there is no other buying power. So the whole project falls to the ground. Java goes elsewhere for the funds required to build its much needed railroad; our manufacturers lose a chance for profitable sales of materials, many young men lose a chance of employment—all because we lack the necessary financial machinery.

The machinery which can supply the buying power in such a case is the debenture company. Obviously, one debenture company would not provide all the capital for a given enterprise. The issue would be distributed among scores of companies, each taking a little, working on the well-known insurance principle of distribution of risk.

As American buying power for foreign securities is made effective, our exports of manufactures to undeveloped countries will increase and we shall witness a world-wide improvement in dollar exchange. The first step must be taken by our statesmen. Opportunities for our financiers, manufacturers, engineers, investors and young men will follow rapidly in the wake of constructive legislation.



UTL AT DOWNSVIEW



D RANGE BAY SHLF POS ITEM C
39 11 11 04 13 011 7